No. 05-130

IN THE

Supreme Court of the United States

EBAY INC.

Petitioner,

v.

MERCEXCHANGE, L.L.C.

Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Federal Circuit

BRIEF OF *AMICUS CURIAE* YAHOO! INC. IN SUPPORT OF PETITIONER

JOSEPH K. SIINO
LISA G. MCFALL
YAHOO! INC.
701 First Avenue
Sunnyvale, CA 94089
(408) 349 3300

ROBERT P. MERGES
U.C. BERKELEY (BOALT HALL) SCHOOL OF LAW
438 Boalt Hall
Berkeley, CA 94720
(510) 643 6199

CHRISTOPHER J. WRIGHT *
TIMOTHY J. SIMEONE
BRUCE L. GOTTLIEB
HARRIS, WILTSHIRE & GRANNIS LLP
1200 Eighteenth Street, N.W.
Washington, D.C. 20036
(202) 730 1300
* *Counsel of Record*

QUESTIONS PRESENTED

The question presented by petitioner is whether the Federal Circuit erred in setting forth a general rule in patent cases that a district court must, absent exceptional circumstances, issue a permanent injunction after a finding of infringement.

This Court directed the parties to address whether it should reconsider its precedents, including *Continental Paper Bag Co. v. Eastern Paper Bag Co.*, 210 U.S. 405 (1908), on when it is appropriate to grant an injunction against a patent infringer.

TABLE OF CONTENTS

INTEREST OF AMICUS CURIAE 1

SUMMARY OF ARGUMENT 2

ARGUMENT 5

I. A RULE MAKING THE ISSUANCE OF AN INJUNCTION VIRTUALLY AUTOMATIC UPON A FINDING OF PATENT INFRINGEMENT PERMITS PATENT TROLLS TO ABUSE THE PATENT SYSTEM. 5

A. Trolls Can Use the Patent System To Ambush Computer and Internet Companies. 6

B. Issuing Injunctions to Trolls Harms Productive Firms. 11

II. TRIAL COURTS HAVE EQUITABLE POWER TO DENY INJUNCTIONS TO PATENT TROLLS. 14

A. Courts Have Traditionally Barred Uses of the Patent System that Are Contrary to the Public Interest. 14

B. This Court Should Not Overrule *Continental Paper Bag*. 18

III. THIS COURT SHOULD PROVIDE SPECIFIC GUIDANCE TO HELP LOWER COURTS IDENTIFY AND DISCOURAGE PATENT TROLLS. 19

CONCLUSION 24

TABLE OF AUTHORITIES

CASES

Page(s)

A.C. Aukerman Co. v. R.L. Chaides Const. Co., 960 F.2d 1020 (Fed. Cir. 1992).....17, 18

Boyden Power-Brake Co. v. Westinghouse, 170 U.S. 537 (1898).....16

City of Milwaukee v. Activated Sludge, 69 F.2d 577 (7th Cir. 1934).....14

Continental Paper Bag Co. v. Eastern Paper Bag Co., 210 U.S. 405 (1908).....*passim*

Edward Miller & Co. v. Bridgeport Brass Co., 104 U.S. 350 (1882).....16

Foster v. American Machine & Foundry Co. 492 F.2d 1317 (2d Cir. 1974).....15, 21

Kewanee Oil Co. v. Bicron Corp., 416 U.S. 470 (1974).....5

Lane & Bodley Co. v. Locke, 150 U.S. 193 (1893).....17

Morton Salt Co. v. G. S. Suppiger Co., 314 U.S. 488 (1942) 16, 23

Nerney v. New York, N.H. & H.R. Co., 83 F.2d 409 (2d Cir. 1936) 15, 21

Odetics, Inc. v. Storage Technology Corp., 185 F.3d 1259 (Fed. Cir. 1999).....11, 17

Rite-Hite Corp. v. Kelley Co., 56 F.3d 1538 (Fed. Cir. 1995). 21

Symbol Techs. Inc. v. Lemelson Med. Educ. & Research Found., 277 F.3d 1361 (Fed. Cir. 2002) & 422 F.3d 1378 (Fed. Cir. 2005).....17, 18

Vitamin Technologists, Inc. v. Wisconsin Alumni Research Found., Inc., 146 F.2d 941 (9th Cir. 1945).....14

Webster Electric Co. v. Splitdorf Electrical Co., 264 U.S. 463 (1924).....17

Wollensak v. Reiher, 115 U.S. 96 (1885) 17

Woodbridge v. United States, 263 U.S. 50 (1923) 17

Young v. Higbee Co., 324 U.S. 204 (1945) 15

CONSTITUTIONAL AND STATUTORY PROVISIONS

U.S. Const. art I, § 8, cl. 8. 5
28 U.S.C. § 1400(b) 13
35 U.S.C. § 122 10
35 U.S.C. § 283 ..... *passim*
35 U.S.C. § 284 ..... 3, 11, 21

OTHER REFERENCES

Michelle Armond, *Introducing the Defense of Independent Invention to Motions for Preliminary Injunctions in Patent Infringement Lawsuits*, 91 Calif. L. Rev. 117 (2003) 17
William M. Bulkeley, "*Court Play: Aggressive Patent Litigants Pose Growing Threat to Big Business*," Wall St. J. (Sept. 14, 2005) 6
Jeremiah Chan & Matthew Fawcett, *Footsteps of the Patent Troll*, 10 No. 1 Intell. Prop. L. Bull 1 (2005) 6, 10
Donald S. Chisum, *Reforming Patent Law Reform*, 4 J. Marshall Rev. Intell. Prop. L. 336 (2005) 9, 12
Federal Trade Comm'n, *To Promote Innovation: The Proper Balance of Competition and Patent Law and Policy* (2003) ..... *passim*
Peter Grindley & David J. Teece, *Managing Intellectual Capital: Licensing and Cross-Licensing in Semiconductors and Electronics*, 39 Cal. Mgmt. Rev. 8 (1997) 14
James Kanter, "*Ownership of Ideas Is High-Stakes Game*," Int'l Herald Trib. (October 3, 2005) 6
Mark A. Lemley, *Rational Ignorance at the Patent Office*, 95 Nw. L. Rev. 1495 (2001) 13

Robert Merges, *Intellectual Property Rights and Bargaining Breakdown: The Case of Blocking Patents*, 62 Tenn. L. Rev. 75 (1994) 16

Robert P. Merges, *Of Property Rules, Coase and Intellectual Property*, 94 Columbia L. Rev. 2655 (1994) 6

Robert P. Merges, *As Many as Six Impossible Patents Before Breakfast: Property Rights for Business Concepts and Patent System Reform*, 14 Berkeley Tech. L.J. 577 (1999) 8

Stephen A. Merrill, *et al.* eds., National Research Council, *A Patent System for the 21st Century* (2004) 6, 8, 9, 10

Note, *The Disclosure Function Of The Patent System (Or Lack Thereof)*, 118 Harv. L. Rev. 2007 (2005) 10

C. Quillen and O. Webster, *Continuing Patent Applications and Performance of the U.S. Patent Office*, 11 Fed. Cir. B. J. 1 (2001) 8

Carl Shapiro, *Navigating the Patent Thicket: Cross Licenses, Patent Pools, and Standard-Setting*, in INNOVATION POLICY AND THE ECONOMY 119 (Adam Jaffee *et al.* eds., 2001) 8, 13

Wendy Schacht and John Thomas, Congressional Research Service, *Patent Reform: Innovation Issues* (Library of Congress 2005) 12

INTEREST OF AMICUS CURIAE[1]

Yahoo! Inc. ("Yahoo!") provides services to more than 411 million individuals each month worldwide and operates the world's most popular Internet destination. The company is a leading innovator in the computer and Internet sector, holds a wide array of patents relating to Internet communication, and also licenses a variety of technology patents both to and from third parties. From time to time, Yahoo! finds it necessary to enforce its own patent rights as well as to defend itself against allegations that it infringed a third party's patent. Accordingly, Yahoo!'s interest is in an efficient patent system that fairly rewards innovation.

Innovation and efficiency will not be advanced by the rule announced by the Federal Circuit in this case, under which permanent injunctions must always issue upon a finding of patent infringement absent a danger to public health or safety. Although permanent injunctions are generally warranted upon a finding of infringement, "patent trolls" – entities whose primary purpose is to tax rather than engage in innovation – should not be allowed to use automatic injunctions to extract settlements greatly exceeding the true economic value of their patents from legitimate companies. This Court should make clear that the lower courts have discretion under 35 U.S.C. § 283 to prevent patent trolls from abusing the patent system in this manner.

---

[1] Counsel for both parties have consented to the filing of this brief, and their consents have been filed with the Clerk of this Court. No counsel for any party authored this brief in whole or in part, and no person or entity, other than the named *amicus curiae* and its counsel, contributed monetarily to the preparation or submission of this brief.

SUMMARY OF ARGUMENT

Patent law rewards innovation by providing an important incentive – the right to exclude – so that inventors will risk investing time and money in the hope of developing new products and processes that will benefit consumers. In many cases, it is appropriate to respond to a finding of patent infringement by granting a permanent injunction to a patent holder.

But "patent trolls" – entities whose primary purpose is to prey on innovators who actually produce societally valuable products – abuse the patent system by obtaining patents for the purpose of coercing settlements from such innovators. Issuing trolls automatic injunctions upon a finding of infringement allows them to extort settlements that vastly exceed the true economic value of their patents and imposes enormous social costs, particularly in the computer and Internet industries. Indeed, the rule adopted in the decision under review creates an enormous incentive for trolls to generate court-clogging, inefficient litigation that disrupts the ongoing operations of genuine innovators.

The decision under review should be reversed because it prevents trial courts from exercising their equity jurisdiction to rein in patent trolls. The Court should make clear that Congress in fact specifically intended trial court judges to possess and exercise that authority. Indeed, the essence of the equitable power expressly reserved by Section 283 is the ability to look through legal niceties to ensure a just and socially efficient result, as courts often do in patent cases.

Distinguishing a patent troll from a party that ought to be awarded an injunction is not always easy. This Court should provide the lower courts specific guidance regarding relevant factors to consider to aid in the exercise of their equitable discretion. The ultimate question is whether future

innovation will be encouraged by strict enforcement of the patent. Accordingly, a particularly important factor in determining whether a patent holder may be a troll is the fundamental nature of the business entity. As noted above, patent law should permit innovators to realize the economic value of their inventions as an incentive to further innovation. But trolls lie outside of that purpose because they exist primarily to tax, not engage in, innovation. More specifically, trolls acquire patents and engage in behaviors to increase the *settlement* value of those patents without adding anything of *societal* value.

A second inquiry for trial courts addressing the propriety of an injunction is therefore whether the patent holder engaged in strategic "troll-like" behavior in order to ambush a legitimate business with its patent. For example, even while operating within the letter of permissible PTO practice, trolls may manipulate those processes to delay patent issuance and thereby set a "trap" for claimed infringement. Alternatively, trolls may delay invoking the patent, knowing that the value of the infringing use to the infringer will increase during the delay. The precise facts that will allow lower courts to detect such abuses of patent processes will vary, of course, but the nature of equity jurisdiction is to allow the courts to assess the totality of the circumstances in order to seek a just and socially rational result.

In short, while trial courts should examine these and any other factors bearing on the equities, patent-monetization entities that have engaged in strategic "troll-like" behavior should not be entitled to injunctions. Indeed, entities established for purposes of patent monetization should be entitled to no more than reasonable damages under Section 284 even when they have *not* engaged in troll-like abuses. A contrary rule would provide undesirable incentives for trolls

to seek settlements in excess of the true economic value of their patents while doing nothing to promote innovation.

Reversing the Federal Circuit's decision and providing the lower courts with guidance concerning the factors that should be used to determine whether to grant an injunction does not require this Court to overturn *Continental Paper Bag Co. v. Eastern Paper Bag Co.*, 210 U.S. 405 (1908). Although the Court in *Continental Paper Bag* correctly held that a patent holder was entitled to an injunction even where it did not use its patent to manufacture products, the Court also recognized that there could be cases where "a court of equity might be justified in withholding relief by injunction." *Id.* at 430. As described more fully in Section III of this brief, availability of injunctions should turn largely on whether the patentee engages in research and development and should discourage entities whose sole business is patent litigation. Under the standard we propose, the plaintiff in *Continental Paper Bag* was not a patent troll and therefore was entitled to an injunction.

The standard we are suggesting will not work a radical change in the operation of the patent system. While troll-initiated litigation is growing rapidly, most patent cases still involve traditional research- or product-oriented patent holders.

In the case at bar, the Court should hold that lower courts may decline to issue an injunction in appropriate cases, and remand for determination in accordance with the factors set out in this brief.

ARGUMENT

I. A RULE MAKING THE ISSUANCE OF AN INJUNCTION VIRTUALLY AUTOMATIC UPON A FINDING OF PATENT INFRINGEMENT PERMITS PATENT TROLLS TO ABUSE THE PATENT SYSTEM.

While some may argue for a severe rollback of patent rights to stop the recent problem of "patent trolls," in our view no fundamental change in patent protections is warranted at this time. The founders of this country, this Court, and Congress have long recognized that strong patent protection promotes innovation and benefits the nation's economy and consumers. As this Court explained:

> The stated objective of the Constitution in granting the power to Congress to legislate in the area of intellectual property is to 'promote the Progress of Science and useful Arts.' The patent laws promote this progress by offering a right of exclusion for a limited period as an incentive to inventors to risk the often enormous costs in terms of time, research, and development. The productive effort thereby fostered will have a positive effect on society through the introduction of new products and processes of manufacture into the economy, and the emanations by way of increased employment and better lives for our citizens.

Kewanee Oil Co. v. Bicron Corp., 416 U.S. 470, 480 (1974) (citing U.S. CONST. art I, § 8, cl. 8.). Indeed, most commentators agree that strong patent protection generally leads to demonstrably positive results and that an injunction is

in most cases the economically appropriate remedy for infringement.[2]

A. Trolls Can Use the Patent System To Ambush Computer and Internet Companies.

The enormous complexity of the computer and Internet sector has, however, given rise to a "new breed of entrepreneurs" known as "patent trolls."[3] These entities do not innovate, but rather seek to acquire broad and nebulous patent claims that arguably encompass existing technologies relied on by companies with deep pockets. By acquiring these claims and threatening or pursuing litigation, the patent trolls seek and often receive economic settlements from genuine innovators and producers that greatly exceed the true economic value of the patents in question. The key weapon

---

[2] *See, e.g.*, Robert P. Merges, *Of Property Rules, Coase and Intellectual Property*, 94 Columbia L. Rev. 2655, 2655 (1994) ("[P]roperty rules can and do work effectively in many situations involving [intellectual property rights]."); Stephen A. Merrill, *et al.* eds., National Research Council, *A Patent System for the 21st Century*, at 21-25 (2004) (describing changes in U.S. patent policy over last 20 years); Federal Trade Comm'n, *To Promote Innovation: The Proper Balance of Competition and Patent Law and Policy* 1:18-23 (2003) (same).

[3] Jeremiah Chan & Matthew Fawcett, *Footsteps of the Patent Troll*, 10 No. 1 Intell. Prop. L. Bull 1 (2005); *see also* William M. Bulkeley, "*Court Play: Aggressive Patent Litigants Pose Growing Threat to Big Business*," Wall St. J., Sept. 14, 2005, at A1; James Kanter, "*Ownership of Ideas Is High-Stakes Game*," Int'l Herald Trib., Oct. 3, 2005, at 1.

wielded by the patent trolls is the threat of a permanent injunction that can "hold up" the sale of a complex product that may incorporate literally thousands of non-infringing patented processes. *See To Promote Innovation* 3:39-41, 3:51-55.

As the Federal Trade Commission recently explained, innovation in the computer and Internet industry is often incremental and cumulative, and the pace of change is rapid.[4] The net result is that each marketable product in this industry may incorporate – often in an incidental, tangential, and sometimes unintentional way – hundreds or even thousands of patented processes. This is commonly described as a "patent thicket": "a dense web of overlapping intellectual

---

[4] *To Promote Innovation* 3:34-37 (discussing computer hardware), 44-46 (computer software and Internet). Notably, the FTC has contrasted Internet and computer innovation with discoveries in the pharmaceutical industry, where most innovation involves discrete discoveries – such as a "new chemical entit[y]" (NCE) – rather than incremental improvements on existing discoveries. *Id.* 3:4-6. This difference in industry structure – rather than any disagreement about the importance of rewarding and protecting genuine innovation – explains why the pharmaceutical companies generally support the wholly mechanical enforcement of patent holders' rights. These companies do not face the problems, described below, that arise when "patent trolls" seek settlements based on alleged infringement by one of *many* patents incorporated in a single computer or Internet product. As explained below, the narrow exception to the general permanent injunction rule that Yahoo! proposes will not adversely impact the intellectual property rights of pharmaceutical companies.

property rights that a company must hack its way through in order to actually commercialize new technology." Carl Shapiro, *Navigating the Patent Thicket: Cross Licenses, Patent Pools, and Standard-Setting*, in INNOVATION POLICY AND THE ECONOMY 119, 120-121 (Adam Jaffee *et al.* eds., 2001); *see also To Promote Innovation* 2:27-31, 3:2, 34-35, 52-53.

The patent thicket and other well-recognized inefficiencies in the current patent system provide the raw material for patent trolls' machinations. As an initial matter, far too many low quality patents issue, as the district court in this case noted.[5] The PTO approves between 85 to 97 percent of the applications it receives. C. Quillen and O. Webster, *Continuing Patent Applications and Performance of the U.S. Patent Office*, 11 Fed. Cir. Bar J. 1, 1-21 (2001). After a careful review of the available evidence, a blue-ribbon panel of the National Research Council recently concluded that "[t]here are several reasons to suspect that more issued patents are deviating from . . . desirable standards of . . . non-obviousness and that this problem is more pronounced in fast-moving areas of technology newly subject to patenting." *A Patent System for the 21st Century* 51. The panel emphasized that the number of patent

---

[5] Pet. App. 57a-58a; *see also* Robert P. Merges, *As Many as Six Impossible Patents Before Breakfast: Property Rights for Business Concepts and Patent System Reform*, 14 Berkeley Tech. L.J. 577, 589 (1999) ("There are persistent reports that patents in the software area, and perhaps especially, patents for 'business methods' implemented in software, are of extremely poor quality," and routinely "overlook clearly anticipating prior art.").

examiners at the PTO has not kept pace with the explosion in the number and complexity of patent applications. *Id.*

In addition, savvy patent practitioners have become skilled at manipulating the PTO's procedures to create "submarine patents," whose existence is hidden until a company with deep pockets has sunk irreversible investment into arguably infringing technology.[6] As the FTC explains the practice, the patent troll frequently "allows its application to languish in the PTO while watching another company make substantial investments in a technology or product that will infringe the yet-to-be-issued patent." *Id.* Then, "[o]nce the other company's sunk costs are large, the patent applicant obtains the patent, asserts infringement, and 'holds up' the other company, demanding supra-competitive royalties for a license to the 'submarine patent.'" *Id.*[7]

---

[6] *To Promote Innovation* 1:26. The term "patent troll" connotes unfair surprise: "[A] troll hides under bridges, metaphorically speaking, waiting for companies to produce and market products, that is, to approach and cross the bridge. The ugly, evil troll then leaps up and demands a huge toll, that is, a licensing fee settling actual or threatened patent litigation, litigation that could result in an injunction halting the product line." Donald S. Chisum, *Reforming Patent Law Reform*, 4 J. Marshall Rev. Intell. Prop. L. 336, 340 (2005); *see also id.* at 348 (criticizing the Federal Circuit's decision in this case on the ground that "injunctions to protect property rights are not automatic and [should] take into account equitable factors").

[7] To address this problem, Congress amended the Patent Act in 1999 to require publication of patent applications within eighteen months of filing. Applicants can avoid this requirement, however, by filing for patent protection only in

To compound the problem, no computer or Internet company can be confident that its product will not ultimately be found by a court to infringe existing patents, even if it engages in an extensive patent search that may substantially delay release of a product and cost millions of dollars. *Footsteps of the Patent Troll*, 10 No. 1 Intell. Prop. L. Bull at 3-4; *To Promote Innovation* 3:53-54, 3:39-40. This is true both because of the sheer number of patents in this area and also because "the metes and bounds of software patent claims are often ambiguous" until *after* the patent is construed by a district or appeals court. *Id.* 3:52. Indeed, the degree of *ex ante* uncertainty is underscored by the fact that a staggering 50 percent of district court patent determinations are overturned at the appellate level. *A Patent System for the 21st Century* 62; *see also id.* at 66 (noting that the average period between patent application and a final ruling on validity is 12.26 years). Moreover, because willful infringement carries a penalty of treble damages, many companies are wary of conducting exhaustive patent searches for fear of later having that fact used against them in an infringement action.[8]

In short, computer or Internet companies conducting their businesses honestly and carefully may find themselves

---

the United States, 35 U.S.C. § 122, and patent trolls frequently do because the additional delay is often worth the cost of foregoing foreign intellectual property protection. Note, *The Disclosure Function Of The Patent System (Or Lack Thereof)*, 118 Harv. L. Rev. 2007, 2024 (2005).

[8] *See generally The Disclosure Function*, 118 Harv. L. Rev. at 2017-23 ("Given the prevalence of willful infringement verdicts in patent suits, innovators are exposed to significant financial risk whenever they search through the patent records.")

accused of infringing low-quality or hard-to-discover patents. By then, a company may have already invested significant amounts in product development that make it very expensive to redesign and redeploy a new product line to avoid the alleged infringement, even though the *ex ante* costs of doing so would have been quite small. *To Promote Innovation* 2:28-29. As the Federal Circuit acknowledged in another case, once a producer has made such investments, the threat of an injunction obliges the producer to

> pay [the patent holder] as much as it would cost to shift to a noninfringing product, an amount, given investment in infringing systems, perhaps far more than a reasonable royalty [as determined pre-investment]. These incentives . . . encourage patentees to adopt a strategy of ambush rather than providing fair notice.

Odetics, Inc. v. Storage Technology Corp., 185 F.3d 1259, 1273 (Fed. Cir. 1999) (case involving patent holder who unreasonably delayed bringing patent enforcement suit). In other words, injunctive relief enables patent trolls to extort settlements greatly in excess of the true economic value of their patents. Under 35 U.S.C. § 284, patent holders are entitled to the generous remedy of "damages adequate to compensate for the infringement but in no event less than a reasonable royalty" – *not* to the much higher payoff they can obtain with the aid of an injunction.

B. Issuing Injunctions to Trolls Harms Productive Firms.

Patent troll tactics are unappealing to true innovators. As a general matter, legitimate computer and Internet companies engage in "defensive patenting" as a way to negotiate the "patent thicket." *To Promote Innovation* 2:26-27, 3:35-36, 52. In other words, a company will patent a

wide range of novel, non-obvious, and useful ideas relating to its products even though it knows that not all those ideas will ultimately be incorporated into its products. These patents help to preserve the company's "freedom to operate" by acknowledging the possibility that, in the future, the company *may* need to use the patented technologies. *Id.* 3:33. In addition, such legitimate industry participants know that they will end up both *holding* patents used by their rivals and *using* patents held by their rivals. In this situation, sometimes described as "mutually assured destruction," each side has a strong incentive to decline to enforce their patents in return for mutual forbearance. *Id.* 2:30-32, 3:37-39, 52. In some cases, these arrangements may be codified in formal "cross licensing" agreements, possibly involving a negotiated monetary exchange if one company's patent holdings are more valuable than another's. *Id.* 3:37-41, 52.

But cross-licensing arrangements and the threat of "mutually assured destruction" do not dissuade patent trolls from asserting unreasonable demands because they are "non-practicing entities." *Id.* 2:31-32, 3:38-39. "Faced with a competitor, [a] company could assert its own patent portfolio and reach a reasonable cross-licensing arrangement. But a troll does not need a license and therefore is uninterested in cross-licensing." Chisum, *Reforming Patent Law Reform,* 4 J. Marshall Rev. Intell. Prop. L. at 340.

Unfortunately, even companies with excellent legal defenses have strong incentives to settle with patent trolls asserting low-quality patents. One "industry rule of thumb" is that it costs $1.5 million to defend a typical case and $4 million to defend a damage claim of over $25 million. Wendy Schacht and John Thomas, Congressional Research Service, *Patent Reform: Innovation Issues* 7-8 (Library of Congress 2005) (noting that one large technology company has an annual patent defense budget of nearly $100 million).

To compound the problem, under current law, plaintiffs are permitted to bring infringement cases in any federal district court with personal jurisdiction over the alleged infringer, which allows patent trolls to shop for courts they consider likely to view their claims favorably. 28 U.S.C. § 1400(b). Accordingly, many companies accept offers from patent trolls to pay license fees, even for dubious patent claims, rather than risk trial. Mark A. Lemley, *Rational Ignorance at the Patent Office,* 95 Nw. L. Rev. 1495, 1517 (2001) (acknowledging that companies will find it rational to pay off patent trolls holding dubious claims).

Taken together, these features of the current patent system enable patent trolls to take particular advantage of software and Internet firms. As noted above, the existence of the patent thicket and the problem of low quality patents make it especially easy for trolls to acquire patents that arguably cover one of the hundreds or thousands of processes incorporated in a single high technology product. The troll waits until a company with deep pockets makes irreversible investments in the arguably infringing technology. The troll may even revise the terms of the patent (through a patent "reissuance" or "continuation") in light of the target's investment in order to strengthen the infringement claim. The troll then uses the threat of an injunction shutting down production to demand a significant share of the total profit associated with the product.

This gamesmanship results in no social benefit and a great deal of harm. First, trolls clog the legal system with complex and bitterly contested litigation. When successful, the trolls also extract large cash settlements from their victims, the companies that actually produce products of social value. Not only are these costs (as well as legal defense fees) eventually passed on to consumers – leading to economic deadweight loss – but in addition "innovation may

suffer because some companies will 'refrain from introducing certain products for fear of hold-up.'" *To Promote Innovation* 3:41 (citing *Navigating the Patent Thicket* at 126; Peter Grindley & David J. Teece, *Managing Intellectual Capital: Licensing and Cross-Licensing in Semiconductors and Electronics*, 39 Cal. Mgmt. Rev. 8, 20 (1997)).

II. TRIAL COURTS HAVE EQUITABLE POWER TO DENY INJUNCTIONS TO PATENT TROLLS.

As other briefs set forth in greater detail, the Federal Circuit's holding is inconsistent with Section 283. That provision states that trial courts "*may grant* injunctions in accordance with the principles of equity to prevent the violation of any right secured by patent, on such terms as the court deems reasonable" (emphasis added). The statute could hardly be more clear that courts likewise *may deny* injunctions when "principles of equity" support that result.

A. Courts Have Traditionally Barred Uses of the Patent System that Are Contrary to the Public Interest.

The Federal Circuit was obliged to acknowledge that the courts have denied injunctions to "protect public health," Pet. App. 26a, but suggested that such circumstances represent the lone limitation on a patentee's general "right to exclude," *id.* at 27a. That suggestion is wholly unsubstantiated. While it is true that some early cases denied injunctions based on a threat to public health or safety, *see, e.g., City of Milwaukee v. Activated Sludge*, 69 F.2d 577, 593 (7th Cir. 1934); *Vitamin Technologists, Inc. v. Wisconsin Alumni Research Found., Inc.*, 146 F.2d 941, 944-45 (9th Cir. 1945), that

justification for withholding injunctive relief has never been exclusive.

To the contrary, in the years before patent appeals were directed exclusively to the Federal Circuit, appellate courts repeatedly upheld the denial of permanent injunctions in patent cases for other reasons. For example, in *Nerney v. New York, N.H. & H.R. Co.*, 83 F.2d 409, 411 (2d Cir. 1936), the court denied a permanent injunction to a railroad company where it was "recognized that the only real advantage to a plaintiff in granting the injunction would be to strengthen its position in negotiating a settlement." And in *Foster v. American Machine & Foundry Co.* 492 F.2d 1317, 1324 (2d Cir. 1974) (some citations omitted), the court denied a permanent injunction to a manufacturer because

> [a]n injunction to protect a patent against infringement, like any other injunction, is an equitable remedy to be determined by the circumstances. 35 U.S.C. § 283. It is not intended as a club to be wielded by a patentee to enhance his negotiating stance. Here, as the District Court noted, the [defendant] manufactures a product; the [plaintiff] does not. In the assessment of relative equities, the court could properly conclude that to impose irreparable hardship on the infringer by injunction, without any concomitant benefit to the patentee, would be inequitable.

More broadly, it is the nature of equity that new situations and even categories of situations will arise as patent practice evolves. As this Court has frequently observed, the essence of the courts' equitable power is the ability to look through legal niceties to ensure a just result. *See, e.g., Young v. Higbee Co.*, 324 U.S. 204, 209 (1945) ("Equity looks to the substance and not merely to the form.").

This has led the Court to well-known decisions such as *Morton Salt Co. v. G. S. Suppiger Co.*, in which it applied equitable principles to deny patent protection to a company using its patent to restrain trade. 314 U.S. 488, 494 (1942) ("The patentee, like these other holders of an exclusive privilege granted in the furtherance of a public policy, may not claim protection of his grant by the courts where it is being used to subvert that policy.").[9]

Of particular importance, this Court has previously invoked its equitable authority to impose limits on a patentee's ability to employ unfair surprise to extort money from genuine innovators who had reasonably relied on the

---

[9] This Court has issued other patent decisions applying equitable principles to prevent savvy parties from subverting the larger purposes of the law. *See, e.g., Edward Miller & Co. v. Bridgeport Brass Co.*, 104 U.S. 350 (1882) (significantly limiting the then-common practice of "reissuing" patents – often based on flimsy assertions that the original application contained a mistake – to prevent harm to parties that had relied on the patent's original specification); *Boyden Power-Brake Co. v. Westinghouse*, 170 U.S. 537, 568 (1898) (finding noninfringement notwithstanding that the product at issue met all the patent claim limitations, because it was "so far changed [in] principle" that it should not, in fairness, be subject to the claim in question). The *Boyden* holding, now known as the "reverse doctrine of equivalents," has been explained by commentators as facilitating follow-on inventors' ability to make improvements to the original design. *See generally* Robert Merges, *Intellectual Property Rights and Bargaining Breakdown: The Case of Blocking Patents*, 62 Tenn. L. Rev. 75 (1994).

protections of the patent system. In *Woodbridge v. United States*, 263 U.S. 50 (1923), and *Webster Electric Co. v. Splitdorf Electrical Co.*, 264 U.S. 463 (1924), the Court developed the equitable doctrine of "prosecution laches." This doctrine prevents parties from benefiting from unreasonable lassitude in seeking issuance of a patent, particularly where the patent holder mounted a strategy of "designed delay" to amend its application in order to generate infringement claims against products created in the intervening period. 263 U.S. at 56, 51-53. Significantly, the Federal Circuit recently reaffirmed and applied the prosecution laches doctrine to patent claims by a notorious businessman – Jerome H. Lemelson – who largely invented the field of patent trolling. *See Symbol Techs. Inc. v. Lemelson Med. Educ. & Research Found.*, 277 F.3d 1361 (Fed. Cir. 2002) & 422 F.3d 1378 (Fed. Cir. 2005); Michelle Armond, *Introducing the Defense of Independent Invention to Motions for Preliminary Injunctions in Patent Infringement Lawsuits*, 91 Calif. L. Rev. 117, 117-120 (2003) (describing Lemelson's tactics).

Similarly, this Court has recognized the equitable defense of laches where a patent holder has unreasonably delayed bringing a suit for patent infringement. *See, e.g., Lane & Bodley Co. v. Locke*, 150 U.S. 193 (1893); *Wollensak v. Reiher*, 115 U.S. 96 (1885). The Federal Circuit routinely applies this rule to prevent damage recovery for the pre-complaint period, *A.C. Aukerman Co. v. R.L. Chaides Const. Co.*, 960 F.2d 1020, 1028-39 (Fed. Cir. 1992) (en banc), and has even made clear that a patent holder cannot seek a permanent injunction under Section 283 for infringing goods produced during a laches period, *Odetics*, 185 F.3d at 1273 ("[A]llowing a patentee who commits laches to enjoin nonetheless the further use of a pre-complaint product will, in many cases, allow the patentee to recover royalties

[through the threat of hold up] that laches specifically prevents.").

As the Federal Circuit has indicated, however, a finding of laches is a severe ruling reserved for only the most "egregious cases" of delay in prosecution, *Lemelson*, 422 F.3d at 1385, and a presumption of ordinary laches arises only if the patent holder has waited more than six years since he or she knew or should have known of the alleged infringement, *A.C. Aukerman*, 960 F.2d at 1028. Laches is, in other words, a blunt instrument. As a practical matter, while it may detect and punish the most "egregious" troll misconduct, it does little to address patentee behavior (in connection with a valid patent) that is "merely" reprehensible. In our view, that is precisely what the lower court discretion inherent in Section 283 can accomplish. By recognizing that the holder of a valid patent may be entitled to not "less than a reasonable royalty" while at the same time denying questionable actors the leverage to extort far larger sums using an injunction, courts of equity can continue to ensure strong patent protection while eliminating the windfall gains that motivate trolls' behavior.

B. This Court Should Not Overrule *Continental Paper Bag*.

Recognizing the lower courts' equitable powers under Section 283 is fully consistent with this Court's ruling in *Continental Paper Bag*. In that case, Continental infringed a patent on a process for making paper bags held by Eastern Paper Bag Company. The Court affirmed the award of an injunction to Eastern, indicating that patents generally confer upon the inventor a "right to exclude" and that an injunction will usually be the appropriate remedy upon a finding of an infringement. 210 U.S. at 425. But the Court ended its decision by specifically stating that there could be cases

where "a court of equity might be justified in withholding relief by injunction." *Id.* at 430.

The main issue in *Continental Paper Bag* was whether the Eastern Paper Bag Company had *unreasonably* failed to use its patent. Continental argued to this Court that the issue "is not that of the simple nonuse of a patent, but a long and unreasonable nonuse of it." 210 U.S. at 427. The Court rejected Continental's argument, finding that Eastern's explanation for nonuse – that it did not use the patent because it did not want to replace its existing machinery with more expensive equipment,. *id.* at 429 – was reasonable.

In our view, an injunction was warranted in *Continental Paper Bag*. Eastern was a true innovator that had not delayed in obtaining its patent or taken any other step suggesting that its intent was to spring the patent on Continental merely to obtain a settlement in excess of a reasonable royalty. Accordingly, it would be entirely appropriate for a trial court today to exercise its equitable authority to grant an injunction in analogous circumstances. As discussed above, computer and Internet innovators frequently obtain patents that they do not currently use and may never use. Indeed, in recent years this practice has become a business necessity helping innovators to navigate the patent thicket while avoiding expensive litigation. In short, *Continental Paper Bag* correctly held that simple nonuse does not warrant the denial of an injunction.

III. THIS COURT SHOULD PROVIDE SPECIFIC GUIDANCE TO HELP LOWER COURTS IDENTIFY AND DISCOURAGE PATENT TROLLS.

As set forth above, this Court's holding in *Continental Paper Bag* indicates both that: (1) an injunction will usually be the appropriate remedy upon a finding of infringement

and (2) there may be cases in which the lower courts may properly withhold an injunction in the exercise of their equitable jurisdiction under Section 283.

In accordance with our discussion of troll behavior (*see supra* Section I), determining whether a particular patent holder should be awarded an injunction demands a fact-specific inquiry that cannot be reduced to a rigid checklist. But two factors are most important in distinguishing patent holders entitled to an injunction from patent trolls that are not. The first is the nature of the entity. If it is an entity organized for the purpose of investing in litigation rather than innovation, a remedy at law is more than adequate to compensate any legitimate claims it might have. The second is whether the entity engaged in any strategic troll-like behavior designed to increase disproportionately the settlement value of its claim. If such an entity set a trap for a productive firm, it should not be entitled to an injunction.

1. The Business Purposes of the Patent Holder. A particularly important factor in determining whether a patent holder may be a troll is the fundamental nature of the business entity. As discussed above, among the purposes of patent law is to allow innovators to realize the economic value of their inventions as an incentive to further innovation. Trolls lie outside of that purpose because they exist primarily to tax innovation rather than engage in it. Their *raison d'être* is to acquire patents and then engage in behaviors that will increase the *settlement* value of those patents without adding anything of *societal* value.

Plainly, a legitimate company that *does* produce something of social value and holds patents related to its products and processes (or markets it seeks to enter) cannot be considered a troll. This describes the majority of patent holders engaged in patent litigation; for them, the standard

we are suggesting will have no impact. Similarly, a legitimate research and development company that recoups its investment by licensing the results of its research is not a troll. This remains true regardless of whether such legitimate product- or research-oriented companies find it useful to create a separate subsidiary, affiliate, or other related entity to hold and enforce its patents. This inquiry should focus not on the narrow corporate entity holding the patents, but on the question of whether that company is part of an overall organization producing something of value or is merely an entity established for purposes of patent monetization through litigation. Entities of the latter type present an asymmetrical threat to potential defendants – unlike legitimate producers, patent trolls have no potentially infringing products of their own, and therefore no incentive to engage in the formal and informal cross-licensing agreements that resolve many claims of infringement without litigation.

Awarding an *automatic* injunction to an entity focused on monetizing patents through litigation would permit it to negotiate a settlement substantially in excess of the true economic value of the infringed patent by enabling it to threaten to shut down the production of socially useful products even where it would suffer no irreparable harm. This point was the key to the approach adopted by the Second Circuit in *Nerney* and *Foster*, where it declined to award injunctions to parties merely to strengthen their settlement position. *Nerney*, 83 F.2d at 411; *Foster*, 492 F.2d at 1324. Moreover, the Federal Circuit has carefully interpreted Section 284, which authorizes damages, to ensure that patent holders receive relief that is proportionate to the contribution of their invention to the overall economic value of the end product. *Rite-Hite Corp. v. Kelley Co.*, 56 F.3d 1538, 1549-51 (Fed. Cir. 1995). If, in contrast, patent

holders receive payments that greatly exceed that amount, they will have incentives to invest disproportionate social resources in "troll-like" behaviors to increase the settlement value of their patents.

A remedy at law should generally be adequate to compensate the legitimate interests of an entity focused on monetizing patents through litigation. Under Section 284, they are entitled to an amount equal to a reasonable royalty upon a finding of infringement. Permitting such an award, while denying the opportunity to extort an additional amount, achieves an equitable result. At the same time, the courts should continue to award injunctions to legitimate companies producing socially valuable products to continue to encourage innovation consistent with the underlying principles of patent law.

2. *Strategic "Troll-Like" Behavior.* A second factor for trial courts to consider is whether the patent holder engaged in strategic "troll-like" behavior in order to ambush a legitimate business with its patent. For example, even while operating within the letter of permissible PTO practice, trolls may manipulate those processes to delay patent issuance for the purpose of setting a "trap" for claimed infringement. Important indicators of this technique include (a) an abnormally long time to publicize the claim, (b) a series of continuations and amendments that reflect post-application developments by firms that develop actual products, and (c) other actions by the patent holder, possibly involving other patents, confirming that the focus of its business is extracting settlements based on dubious patent infringement claims.

Trial courts also should consider whether the patent holder engaged in other forms of delay or abuse – for example, in invoking the patent – knowing that the value of the infringing use to the infringer would increase during the

delay. Frequently, trolls deliberately wait until *after* the target company makes large and irreversible investments in a particular technology before springing the patent trap. The precise facts that allow lower courts to "smoke out" such abusers of the patent system will vary, of course, from case to case – but the nature of equity jurisdiction is to allow lower courts to assess the totality of the circumstances in order to seek a just and socially rational result. As this Court has explained, "[u]ndoubtedly 'equity does not demand that its suitors shall have led blameless lives,' but additional considerations must be taken into account where maintenance of the suit concerns the public interest as well as the private interests of suitors." *Morton Salt*, 314 U.S. at 493 (internal citations omitted).

In sum, we propose two factors for courts to consider in weighing the equities: (1) the business purpose of the patent holder; and (2) strategic "troll-like" behavior. We believe these factors preserve the judiciary's equitable jurisdiction while maintaining a strong patent system that protects true innovators.

CONCLUSION

The decision of the Federal Circuit should be reversed. However, this Court need not, and should not, reverse its decision in *Continental Paper Bag*. On remand, the courts below should exercise their equitable authority under Section 283 to grant or deny an injunction consistent with the guidance provided by this Court.

Respectfully submitted,

JOSEPH K. SIINO
LISA G. MCFALL
YAHOO! INC.
701 First Avenue
Sunnyvale, CA 94089
(408) 349 3300

ROBERT P. MERGES
U.C. BERKELEY (BOALT HALL) SCHOOL OF LAW
438 Boalt Hall
Berkeley, CA 94720
(510) 643 6199

CHRISTOPHER J. WRIGHT *
TIMOTHY J. SIMEONE
BRUCE L. GOTTLIEB
HARRIS, WILTSHIRE & GRANNIS LLP
1200 Eighteenth Street, N.W.
Washington, D.C. 20036
(202) 730 1300
* *Counsel of Record*

January 26, 2006